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SUBJECT: VIETNAM'S SMEs THIRSTY FOR CAPITAL

Ref: Hanoi 377

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¶1. Summary: Tight monetary policy has limited access to credit for Vietnam's small and medium enterprises (SMEs). SMEs are feeling the pinch, with many complaining that bank lending has dried up completely. The GVN is aware of the issue and is taking steps to improve access to credit, including loosening liquidity and directing the state owned commercial banks to improve SME lending. The GVN is also reexamining its failed SME credit guaranty program. End Summary.

TIGHT MONETARY POLICY CUTS LENDING

¶2. (U) As previously reported, Vietnam has struggled with inflation in 2008. Although recent numbers show improvement, year-on-year inflation is still at 27.9 percent as of September 2008. The PM has identified controlling inflation as the GVN's top priority for 2008 (reftel). To achieve this goal, the GVN, via the State Bank of Vietnam (SBV), has adopted a tight monetary policy focused on reducing the money supply. Earlier this year, the SBV also announced a credit growth rate target of 30 percent for the banking sector, down from at least 53 percent in 2007. (Note: Although the SBV reports average credit growth of 53% for 2007, many banks privately admit to credit growth of 90 to well over 100 percent last year.)

¶3. (SBU) In an effort to comply with the SBV's credit growth numbers and in response to tightened liquidity, commercial banks in Vietnam have had to tighten their lending portfolios. As a result, businesses in general have had difficulty getting credit for either ongoing business or expansion. Only 10.5 percent out of 282 surveyed enterprises had their financing needs met in the first six months of 2008, according to a survey conducted by the Vietnam Chamber of Commerce and Industry (VCCI)'s Institute of Enterprises Development. At the same time, the GVN, in an effort to sustain economic growth, has directed banks to lend their limited funds to certain commodity and export-related industries. Many economists and analysts also believe that too much of the available capital has been funneled into Vietnam's powerful state owned enterprises (SOEs).

SMEs STRUGGLE FOR FINANCING

¶4. (SBU) In this credit environment, Small and Medium Enterprises' (SMEs) access to credit has become more challenging. A

representative of the SMEs Association in HCMC told us that "it's very difficult. It's difficult for SMEs to get bank loans for both capital goods financing and working capital." For SMEs, banks tend to require collateral and/or a credit guarantee to consider providing a loan. With a tightened credit policy in place, banks are inclined to provide credit to large, well established, reputable firms or companies with whom they have a special relationship. Even if they can get credit, the cost of borrowing is a heavy burden on the SMEs. Lending rates rose from 12-13 percent per annum in 2007 to up to 20-21 percent this year, making the cost of capital out of reach for some small businesses.

¶15. (SBU) From the banks' viewpoint, it is difficult to lend to SMEs even when liquidity is ample. "These enterprises do not know how to borrow, how to make a business plan, their collateral is not sufficient, and their financial statements, if any, are not transparent," according to an executive vice president at Techcom Bank, a large commercial bank with a stated interest in lending to SMEs. Bankers also cite other constraints in lending, including the current high cost of capital, lack of SME credit guaranty, and the extreme difficulty of repossessing collateral if a borrower defaults.

¶16. (SBU) The GVN is aware that SMEs are struggling. Following a series of negative press reports citing SME complaints about credit, the SBV released a study that painted a mixed picture about SMEs. According to the report, total outstanding loans provided to SMEs by July 31, 2008 reached VND 299,472 billion (\$18,717 million), accounting for 27.3 percent of total outstanding loans in the economy, an increase of 16.65 percent compared to December 31, 2007. The report also stated that 23 percent of the SMEs which have "borrowing relationships" with banks are doing well, 73.2 percent are average performers, 3.8 percent face difficulties, and only 1.42 percent are at risk of bankruptcy.

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¶17. (SBU) The real situation, however, seems more difficult. An official at the SME Association in Hanoi told us that she was aware of the report but that "(she) has not heard from our members about easier access to banks loans". According to another member of the SME Association, while many banks claim interest in SME lending, they are not following through with real action or "putting their money where their mouth is."

¶18. (SBU) Vietnam's current tight monetary policy could bankrupt 20 percent of the country's small to medium sized enterprises (SMEs), according to Dr. Cao Sy Khiem, Chairman of Vietnam's SME Association and former Governor of the SBV. Khiem told P?u Tu T`i Chnh (Financial Investment) that another 60 percent of SMEs are facing difficulties while just 20 percent are unaffected. This expert suggests the GVN should help SMEs by extending corporate tax deadlines, reforming Vietnam's tax systems and customs, and setting up credit guarantee and insurance facilities for the SMEs.

THE GVN RESPONDS

¶19. (U) The GVN has taken some steps to ease access to credit. On October 20, the SBV raised the interest rate paid on banks' compulsory reserves to 10 percent from 5 percent and lowered the base rate from 14 to 13 percent. It also allowed banks to use the SBV compulsory bills to participate in refinancing transactions (such as borrowing, discounting or open market operations) with the SBV. These moves were designed to enhance liquidity in the system and to enable banks to cut lending rates.

¶10. (SBU) Many state owned commercial banks, likely at the behest of the GVN, have also announced financing programs for SMEs. The Bank for Investment and Development of Vietnam (BIDV) announced VND 33 trillion (\$1.9 billion) loans for SMEs during 2008-2010, which will be used to help restructure debts of SMEs. It planned to disburse VND 3 trillion (\$178 million) in 2008, VND 10 trillion (\$594 million) in 2009, and VND 20 trillion (\$1.2 billion) in 2010. BIDV

expects to have outstanding SME loans of VND 100 trillion (\$5.9 billion) by 2010, which will account for 50% of the bank's total outstanding loans. The Industrial and Commercial Bank has allocated VND 10 trillion (\$594 million) for its SME lending portfolio. Lastly, Vietcombank has set aside VND 3 trillion (\$178 million) to support SMEs and says that its target is to have 25 percent of its lending portfolio in SMEs.

¶11. (SBU) The GVN is also making attempts to resuscitate its SME credit guaranty program. While the program has been on the books for about ten years, it is not yet functional due to structural issues. The fund(s), while overseen by Ministry of Finance (MOF), are supposed to be established, managed and financed by each individual province. To date, only ten such funds have been established, with the vast majority of provinces not able or willing to participate in the program. Concerned ministries, the SME Association, and local banks agree that most provinces lack the financial and human resources to comply with the program's requirements. The PM has now tasked MOF with fixing the program, even if it means centralizing the fund.

¶12. (SBU) Comment: SMEs employ a significant number of Vietnamese workers and account for 30 to 40 percent of GDP so the GVN is right to be concerned about their welfare. The GVN knows that bankruptcies would have a devastating effect on employment numbers and is trying to bolster this vulnerable part of the economy. Unfortunately, too much attention and capital has been directed to the large, inefficient SOEs that function as the GVN's political patronage machine. The PM's newfound interest in the SME credit guaranty program is a positive indicator that the SMEs are finally being heard. Not coincidentally, MOF is now welcoming our Treasury's SME credit guaranty technical assistance program, which is well placed to address the fund's problems. End comment.

¶13. (U) This cable was coordinated with Con Gen HCMC.

MICHALAK